# Council

Tuesday, 22nd February 2022, 6.30 pm
Council Chamber, Town Hall, Chorley and YouTube

I am now able to enclose, for consideration at the above meeting of the Council, the following reports that were unavailable when the agenda was published.



Gary Hall
Chief Executive

Electronic agendas sent to Members of the Council

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South Ribble Borough Council | Chorley Council
WORKING TOGETHER

# Job Description

## Shared Chief Executive

## Spot Salary: £145,000

## Responsible To:

The Full Councils of Chorley Council and South Ribble Borough Council

## Responsible For:

All employees of Chorley Council and South Ribble Borough Council

## About the job:

To deliver the councils' corporate and partnership priorities in line with the councils' Corporate Strategies.

As the Head of Paid Service to ensure the effective strategic leadership of the council's Senior Management Team and be the Council's principal policy adviser in order to support the delivery of excellent services in accordance with Council policy, budgetary and statutory requirements.

## Role:

To act as the councils' principal adviser to the elected leadership of the councils on policy options and the forward planning of objectives, services, and resources to deliver the sovereign councils' ambitions for the boroughs.

To provide leadership, direction and management of the officers of the councils to ensure the delivery of the council's Corporate Strategies and the provision of high quality, cost effective services based on community needs.

Manage the interface between Elected Members and Senior Officers, promoting a positive and respectful relationship between Members and Officers.

Provide strong visible leadership and direction to the councils' workforces to deliver Council and community priorities, maximising potential and developing a culture of accountability and empowerment.

To ensure that the councils have appropriate governance and regulatory systems and controls in place and adhered to, which are modern, flexible, fit for purpose and proportionate.

Ensure the performance of such emergency planning functions together with any other reasonable duties that may be required to maintain services.

To undertake any other duties incidental to the role of Chief Executive of the councils.

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## Responsibilities:

**Team:**

- You will manage individual and team performance to ensure that agreed targets and outcomes are achieved and that quality services are provided at all times, in line with our HR policies
- You will be responsible for all aspects of staffing matters related to the Team including recruitment, appraisals, absence management, capability and discipline
- You will participate in and deliver staff development activities as required

**Corporate:**

- You will carry out your duties and responsibilities in line with the Health & Safety Policy and associated legislation.
- You will actively engage with customer care, value for money and performance management.
- Your duties will be carried out in line with our equality scheme.
- You will be compliant at all times with GDPR and data protection legislation.
- You will constructively participate in communication and promotional activities.

**Organisational:**

- You will be committed to ensuring that shared services works for each organisation and act as an advocate for its development over time
- You will be prepared to take on responsibilities and projects that may be outside of your normal work area but are relevant to your role.
- You will support an inclusive culture which provides opportunities for everyone to participate and progress.
- You will support effective relationships across all directorates, with stakeholders and external partners to ensure each council's priorities and objectives are met.
- You will positively promote and represent each council at all times.

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## What the successful candidate will have:

- Relevant postgraduate master's degree or equivalent qualification and/or extensive relevant experience
- Be able to demonstrate a commitment to professional development
- Have significant experience of managing relevant teams and functions with demonstrable success at a comparable scale and level of complexity
- Have experience of managing a range of multi – disciplinary projects using transferable skills to move between projects and teams to drive delivery and achieve benefits
- Be able to demonstrate effective written and verbal communication skills
- Be able to work as part of a team, maximising available resources
- Be able to plan and organise a varied workload with shifting deadlines and priorities.
- Be able to challenge service performance, identifying and implementing improvements

## You will play a key part in our organisational culture:

**A LEARNING FORWARD THINKING ORGANISATION** – Plans and prioritises effectively deciding what to do and what not to do, if unsure ask

**RESPECT AND INTEGRITY** – Is visible, approachable, open and honest with colleagues.

**PRIDE** – Creates an upbeat, positive culture among colleagues.

**TWO COUNCILS, ONE SHARED SERVICE** – Builds effective relationships outside their immediate team, with win-win relationships for all

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**APPENDIX H i)**

Chorley Council

| Report of | Meeting | Date |
|---|---|---|
| Chief Finance Officer & Section 151 Officer | Special Council | 22 February 2022 |

# TREASURY STRATEGY 2022/23 TO 2024/25

## PURPOSE OF REPORT

1. To present the Prudential and Treasury Indicators and Treasury Management and Investment Strategies for 2022/23 to 2024/25, and the Minimum Revenue Provision (MRP) Policy Statement for 2022/23.

## RECOMMENDATION(S)

2. That Council approve:
   - The capital expenditure Prudential Indicators for 2022/23 to 2024/25 in Tables 1 to 5.
   - The annual Minimum Revenue Provision (MRP) Policy statement starting at paragraph 37.
   - The Treasury Management Strategy and treasury management Prudential Indicators for 2022/23 to 2024/25, in Tables 6 to 10.
   - The Annual Investment Strategy 2022/23 including Investment Counterparties starting at paragraph 73.

## EXECUTIVE SUMMARY OF REPORT

3. This report incorporates the implications for treasury management of both financial and non-financial (income generating assets) investments. The wider approach to non-financial investments and to the capital expenditure as a whole is set out in more detail in the Capital Strategy report, which appears as Appendix G to the Budget report.

4. The report presents the Prudential Indicators in respect of capital expenditure and financing, the forecast levels of external borrowing and investments.

5. A review of the Council's Minimum Revenue Provision (MRP) policy has been undertaken. As a result of this review, the proposed MRP Policy for 2022/23 is amended, compared to that for 2021/22. The policy continues to be based on the current Statutory Guidance, as issued in February 2019 and effective from 1 April 2019. The Government is currently consulting on proposed changes to the regulations, but neither of the proposed changes would impact upon the Council's proposed or previous MRP policies.

6. The proposed list of investment counterparties for 2022/23 and associated limits per institution are unchanged from those for 2021/22.

7. Following the cessation of the publication of LIBOR/LIBID figures, which were previously used to set an investment performance benchmark, the Council is recommended to adopt a new benchmark rate based on the SONIA (Sterling Overnight Index Average) 7-day compounded rate.

| Confidential report<br>Please bold as appropriate | Yes | **No** |
|---|---|---|

| Key Decision?<br>Please bold as appropriate | Yes | **No** |
|---|---|---|

## REASONS FOR RECOMMENDATIONS

8. Approval of the Prudential Indicators, Treasury Management Strategy, Treasury Indicators, Annual Investment Strategy, and Annual MRP Policy Statement is necessary to comply with statutory requirements.

## ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

9. None.

## CORPORATE PRIORITIES

10. This report relates to the following Strategic Objectives:

| | | | |
|---|---|---|---|
| Involving residents in improving their local area and equality of access for all | | A strong local economy | |
| Clean, safe and healthy homes and communities | | An ambitious council that does more to meet the needs of residents and the local area | ✓ |

## BACKGROUND

11. At its meeting on 23 February 2021, Council approved the Treasury Management Strategy for 2021/22, including Prudential and Treasury Indicators, the Treasury Management and Investment Strategies, and the annual Minimum Revenue Provision (MRP) Policy Statement for 2021/22. Treasury Management activities during the year have been overseen by the Governance Committee.

12. This report updates the Prudential and Treasury Indicators for financial years 2021/22 to 2024/25. It presents updated Treasury Management and Investment Strategies, including a revised list of Investment Counterparties, and proposes the Minimum Revenue Provision (MRP) Policy Statement for 2022/23.

13. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments, commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

14. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses.

15. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as *"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

16. The Treasury Management Policy Statement for 2022/23 is based upon the Chief Finance Officer (s151 officer) and Treasury Officers' views on interest rates supplemented by leading market forecasts. The policy statement covers:
    a) The policy for managing capital borrowing and debt rescheduling
    b) The annual investment strategy for treasury management investments
    c) Reporting arrangements
    d) Training arrangements
    e) Performance indicators
    f) Minimum Revenue Provision (MRP) Policy
    g) Use of treasury management advisors

**CAPITAL STRATEGY**

17. Under the latest Prudential and Treasury Management Codes, in addition to the Treasury Management Strategy, all local authorities are now required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:
    - a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
    - an overview of how the associated risk is managed
    - the implications for future financial sustainability

18. The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy. The Strategy both complements and supplements the Treasury Management Strategy and the two documents should be read in conjunction.

19. The Capital Strategy for 2022/23 appears at Appendix G to the 2022/23 budget report.

**TREASURY MANAGEMENT STRATEGY 2022/23**

20. The strategy for 2022/23 covers two main areas:

**Capital issues**

- the capital plans and the associated Prudential Indicators;
- the Minimum Revenue Provision (MRP) policy.

**Treasury management issues**

- the current treasury position;
- Treasury Indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

21. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, DLUHC MRP Guidance, the CIPFA Treasury Management Code, and DLUHC Investment Guidance.

**TRAINING**

22. The CIPFA Code requires the Responsible Officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

23. The training needs of treasury management officers are reviewed periodically. Both CIPFA and Link Asset Services provide workshops and seminars.

**TREASURY MANAGEMENT CONSULTANTS**

24. The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors. The advisors provide access to specialist skills and resources including
    - Technical support on treasury matters and capital finance issues.
    - Economic and interest rate analysis.
    - Debt services, which includes advice on the timing of borrowing.
    - Debt rescheduling advice surrounding the existing portfolio.
    - Generic investment advice on interest rates, timing and investment instruments.
    - Credit ratings/market information service comprising the three main credit rating agencies.

25. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

26. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

**CAPITAL PRUDENTIAL INDICATORS 2022/23 – 2024/25 AND MRP STATEMENT**

27. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

**Capital expenditure**

28. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

| Table 1 - Capital Expenditure | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| A Strong Local Economy | 11,579 | 9,452 | 1,300 | 300 |
| An Ambitious Council | 2,804 | 1,570 | 0 | 0 |
| Clean, Safe and Healthy Homes & Communities | 12,107 | 12,724 | 875 | 875 |
| Involving Residents | 2,112 | 489 | 0 | 0 |
| **Capital Expenditure Total** | **28,602** | **24,235** | **2,175** | **1,175** |

29. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

| Table 2 - Capital Financing | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| Capital expenditure from Table 1 | 28,602 | 24,235 | 2,175 | 1,175 |
| Capital Receipts | (300) | (1,000) | 0 | 0 |
| Grants & Contributions | (12,307) | (6,129) | (775) | (775) |
| Revenue and Reserves | (1,025) | (1,795) | 0 | 0 |
| **Net financing needed for year** | **14,970** | **15,311** | **1,400** | **400** |

**The Council's borrowing need (the Capital Financing Requirement)**

30. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

31. The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

32. The Council is asked to approve the CFR projections below:

| Table 3 - Capital Financing Requirement | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| Opening CFR | 89,271 | 103,027 | 116,843 | 116,461 |
| Net financing need for the year (Table 2) | 14,970 | 15,311 | 1,400 | 400 |
| Less MRP/VRP | (1,214) | (1,495) | (1,782) | (1,845) |
| **Closing CFR** | **103,027** | **116,843** | **116,461** | **115,016** |

**Minimum Revenue Provision (MRP) Policy Statement**

33. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

34. DLUHC regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

35. In setting the 2022/23 Budget, the Council has reviewed its approach to MRP, key changes are summarised in the table below;

| | Previous Approach | Proposed Approach |
|---|---|---|
| Pre 2008 Debt | The Council has charged the MRP on pre-2008 debt in “equal annual instalments”; this is a **prudent** approach as it ensures debt is cleared fully. | No change |
| Post 2008 Debt | The Council has adopted a varied approach; charging MRP largely in equal instalments over the life of an asset; however using an annuity basis for income generating schemes.<br><br>The annuity basis recognises the “real terms” value of money over time (£1 now being worth less in future years).<br><br>The annuity method is considered to be more equitable. | On the grounds of adopting a **consistent**, and more **equitable** approach, it is proposed to adopt the “annuity basis” for <u>all</u> post 2008 debt.<br><br>The proposed change remains **prudent** as it still spreads the MRP fully over the life of the asset. |
| Asset Lives | The Council has adopted varying asset lives for new income generating assets; some with a life of 40 years (Logistics House, Primrose Court); others with a life of 50 years (Market | To ensure a **consistent** approach, it is proposed that an asset life of 50 years is adopted for all new income generating |

| | | |
|---|---|---|
| | Walk / Strawberry Fields). | assets. |

36. The Council is recommended to approve the following MRP Policy Statement:

**Annual Statement of MRP Policy 2022/23**

37. The aim of the policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits.

38. MRP shall commence in the financial year following that in which the capital expenditure is incurred, or in the year following that in which the relevant asset becomes operational.

39. In respect of the proportion of the Capital Financing Requirement which relates to debt incurred prior to 2008/09, MRP shall be charged in equal annual instalments over the life of assets (Equal instalment method). This generates a series of equal annual amounts over the life of each asset that is financed by borrowing, with the life determined upon acquisition. This means that the charge to revenue closely matches the period of economic benefit of the asset. This method is considered prudent as it ensures the debt is cleared in full over the life of the asset.

40. The MRP liability on debt incurred from 2008/09 onwards shall be based on the estimated useful life of the asset. The MRP shall be calculated using the annuity basis where the principal repayments increase over the life of the asset to reflect the “real terms” value of money over time.

41. Estimated life periods shall be determined under delegated powers, with reference to the guidance and advice of appropriate professional advisers, in the year that MRP commences. As some types of capital expenditure are not capable of being related to an individual asset, the MRP shall be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

42. The change in MRP policy has the following financial impact;

| Years | Saving (-) / Additional Cost (£) |
|---|---|
| 0 – 5 | -477,314 |
| 6 – 10 | 48,921 |
| 11 – 15 | 51,655 |
| 16 – 20 | 41,309 |
| 21 – 25 | 48,891 |
| 26 – 30 | 55,738 |
| 31 - 35 | 62,637 |
| 36 – 40 | 1,512,695* |
| 41 – 45 | -136,218 |
| 46 - 50 | -1,208,315* |
| TOTAL | 0 |

Notes:

- * Relates to the extension of asset lives for Logistics House & Primrose Court (40 to 50 Years)
- The overall effect of the changes is NIL – essentially this is a reprofiling exercise to reflect the real terms value of money over time.
- Figures are based upon current forecasts of Capital Expenditure; inevitably these will change as schemes slip / new schemes are introduced; for this reason, the MRP Policy and budgets are reviewed annually.

43. The Government (DLUHC) is currently consulting on proposed changes to MRP regulation as follows;
    - Capital receipts may not be used in place of the revenue charge. The intent is to prevent authorities avoiding, in whole or part, a prudent charge to revenue. It is not the intention to prevent authorities using capital receipts to reduce their overall debt position, which may have the effect of reducing the MRP made with respect to the remaining debt balance.
    - Prudent MRP must be determined with respect to the authority's total capital financing requirement. The intent is to stop the intentional exclusion of debt from the MRP determination because it relates to an investment asset or capital loan. Authorities should still be able to charge MRP over the period in which their capital expenditure provides benefits and begin charging MRP in the year following capital expenditure, in accordance with proper accounting practices set out in the government's statutory guidance on Minimum Revenue Provision.

44. Neither of these changes impact upon either the current or proposed MRP Policy at the Council.

45. Members will be informed of the outcome of this consultation and if there are any relevant changes to the Council's MRP Policy in the mid-year Treasury Management Review Report 2022/23.

**Affordability prudential indicators**

46. The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

**Ratio of financing costs to net revenue stream**

47. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| Table 4 - Ratio of Financing Costs to Net Revenue Stream | 2021/22 Estimate % | 2022/23 Estimate % | 2023/24 Estimate % | 2024/25 Estimate % |
|---|---|---|---|---|
| Ratio | 17.12 | 23.82 | 28.73 | 28.70 |

48. The estimates of financing costs include current commitments and the proposals in the revenue and capital budget report.

49. This table now includes within the Net Revenue Stream not only income from taxation (Council Tax and Business Rates) and general government grants, but also that from income-generating assets. The Financing Costs also include the debt repayment and interest in respect of such assets. Table 4A below compares the income derived from these assets against the total financing cost incurred by the Council. It is emphasised that the comparison

is against the total financing cost and not only that which relates to the assets themselves. Further detail is contained in the Capital Strategy.

| Table 4A - Investment Income in Excess of Borrowing | 2021/22 Estimate % | 2022/23 Estimate % | 2023/24 Estimate % | 2024/25 Estimate % |
|---|---|---|---|---|
| Total Borrowing Costs | 2,775 | 3,405 | 3,354 | 3,320 |
| Net Income From Non-Financial Investments | (4,003) | (4,910) | (5,800) | (5,796) |
| Investment Income in Excess of Borrowing Costs | (1,228) | (1,505) | (2,446) | (2,476) |

**Core funds and expected investment balances**

50. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

| Table 5 - Year-End Resources | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| Core Funds/Working Balances | (28,781) | (20,963) | (22,045) | (22,997) |
| Under/(over) borrowing (Table 6) | 22,781 | 18,963 | 20,045 | 20,997 |
| **Expected investments** | **(6,000)** | **(2,000)** | **(2,000)** | **(2,000)** |

**BORROWING**

51. The capital expenditure plans set out in paragraph 28 above provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant Treasury / Prudential Indicators, the current and projected debt positions and the annual Investment Strategy.

**Current portfolio position**

52. The Council's projected treasury portfolio position is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

| Table 6 - Portfolio Position | 2020/21 Actual £000 | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|---|
| Debt at 1 April | 64,026 | 62,156 | 80,231 | 97,865 | 96,401 |
| Other long-term liabilities (OLTL) | 15 | 15 | 15 | 15 | 15 |
| Total gross debt 1 April | 64,041 | 62,171 | 80,246 | 97,880 | 96,416 |
| Expected change in Debt | (1,870) | 18,075 | 17,634 | (1,464) | (2,397) |
| Expected change in OLTL | 0 | 0 | 0 | 0 | 0 |
| Expected change in gross debt | (1,870) | 18,075 | 17,634 | (1,464) | (2,397) |
| Gross debt 31 March | 62,171 | 80,246 | 97,880 | 96,416 | 94,019 |
| Capital Financing Requirement (Table 3) | 89,271 | 103,027 | 116,843 | 116,461 | 115,016 |
| **Under / (over) borrowing** | **27,100** | **22,781** | **18,963** | **20,045** | **20,997** |

53. The figures for long-term liabilities in the above table relates to leases which the Council has entered into, based on current accounting requirements. Currently, a new accounting standard for leasing, IFRS 16, is due to be introduced for application in the Council's 2022/23 financial statements. The impact of this on those statements will be fully assessed during the year and, if necessary, a revision to the figures shown here may be brought to Council for approval. However, CIPFA is currently undertaking a review which may result in the further deferment of the implementation of IFRS 16 to 2023/24 or even to 2024/25.

**Treasury Indicators: limits to borrowing activity**

54. Within the prudential indicators there are two key indicators to ensure that the Council operates its activities within well-defined limits. These are the Operational Boundary and the Authorised Limit. The principal aim is to ensure that borrowing is only undertaken in respect of previous and approved future capital spending and not for revenue or speculative purposes. This is achieved by setting limits which restrict the amount of borrowing which can be undertaken to that required to finance the current underlying borrowing requirement (ie the CFR), plus the impacts of approved capital schemes for each of the coming three financial years. This is the Operational Boundary. To allow for some operational flexibility in the timing of borrowing, scope is provided for some headroom above this, but this is only to be used on a short-term basis and is subject to a maximum limit which may not be exceeded. This is the Authorised Limit. Further detail of both indicators is set out below.

55. The S151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

56. **The Operational Boundary.** This is the limit which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

| Table 7 - Operational Boundary | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| Debt | 84,200 | 102,600 | 101,300 | 98,900 |
| Other long-term liabilities | 15 | 15 | 15 | 15 |
| **Operational Boundary** | **84,215** | **102,615** | **101,315** | **98,915** |

57. **The Authorised Limit for external debt.** This further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects a level of external debt which, while not desired, could be afforded in the short term, but which is not demonstrably prudential in the longer term.

- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

58. The Council is asked to approve the following Authorised Limit:

| Table 8 - Authorised Limit | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| Debt | 88,500 | 107,800 | 106,400 | 103,900 |
| Other long-term liabilities | 15 | 15 | 15 | 15 |
| **Authorised Limit** | **88,515** | **107,815** | **106,415** | **103,915** |

**Maturity structure of borrowing**

59. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

60. The Council is asked to approve the following treasury indicators and limits:

| Table 9 - Maturity Structure of Borrowing | | | |
|---|---|---|---|
| **Maturity structure of fixed interest rate borrowing 2021/22** | | | |
| | **31/3/22** | **Lower** | **Upper** |
| Under 12 months | 3% | 0% | 30% |
| 12 months to 2 years | 3% | 0% | 30% |
| 2 years to 5 years | 9% | 0% | 40% |
| 5 years to 10 years | 15% | 0% | 50% |
| Over 10 years | 70% | 0% | 80% |

61. The column headed 31/3/22 is the forecast split of borrowing as at the end of the current **financial** year and includes estimated temporary borrowing. The column for the Upper limit is in respect of borrowing in 2022/23. It indicates that borrowing is likely to be for a range of maturities.

It is not anticipated that any borrowing will be taken at variable interest rates.

**Control of interest rate exposure**

62. Please see the summary in this report and the advice of Link Assets Services on prospects for interest rates in Appendix H2.

63. The table in Appendix H2 compares the forecast of a year ago with that prepared for the mid-year review, and the current forecast.

**Prospects for borrowing interest rates**

64. The Bank of England's Monetary Policy Committee (MPC) made a significant move at its meeting in the first week of February 2022, raising Bank Rate by another 0.25% to 0.50% and only narrowly deciding against a 0.50% increase by a 5-4 voting margin. The Council's treasury advisor's forecast now expects the MPC to deliver another 0.25% increase in March; with its position seeming to be to go for sharp increases to get address its objectives quickly. The March increase is expected to be followed by an increase to 1.0% in May and then to 1.25% in November. The Committee is currently much more closely focused on combating inflation than on protecting economic growth.

65. In respect of PWLB rates, the advice received is that the yield curve has flattened out considerably, with the view being that the markets as have already built in nearly all the effects on gilt yields of the likely increases in Bank Rate. Since the start of 2021, there has been a lot of volatility in gilt yields, and hence in PWLB rates. Current forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

66. Based upon the capital plans set out above, the Council will need to enter into further long-term external borrowing during the term of this strategy.

**Borrowing strategy**

67. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (ie the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

68. Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates*, then borrowing will be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast*, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

69. Any decisions will be reported at the next available opportunity.

**Policy on borrowing in advance of need**

70. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully

to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

71. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

## ANNUAL INVESTMENT STRATEGY

### Investment Policy – management of risk

72. The DLUHC and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy at Appendix H to the Budget report.

The Council's investment policy has regard to

- the DLUHC's Guidance on Local Government Investments ("the Guidance"),
- CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the CIPFA TM Code"), and
- CIPFA Treasury Management Guidance Notes 2021.

73. The Council's investment priorities will be **S**ecurity first, portfolio **L**iquidity second, and only then return (**Y**ield).

74. The above guidance from the DLUHC and CIPFA places a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

- Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

- **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

- **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

- This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use.

  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

- **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being £4 million. See Table 10 below.

- **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 86.

- **Transaction limits** are set for each type of investment in paragraph 86.

- This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see Table 10).

- Investments will only be placed with UK counterparties.

- This authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

- All investments will be denominated in **sterling**.

**Creditworthiness policy**

75. The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

    - credit watches and credit outlooks from credit rating agencies;
    - CDS spreads to give early warning of likely changes in credit ratings;
    - sovereign ratings to select counterparties from only the most creditworthy countries.

76. This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

| | |
|---|---|
| **Yellow** | 5 years |
| **Purple** | 2 years |
| **Blue** | 1 year (only applies to nationalised or semi nationalised UK Banks) |
| **Orange** | 1 year |
| **Red** | 6 months |
| **Green** | 100 days |
| **No colour** | Not to be used |

77. The yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.

78. The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

79. Typically, the minimum credit ratings criteria the Council use will be a Short-Term rating (Fitch or equivalents) of F1 and a Long-Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

80. All credit ratings will be monitored weekly and will be checked at the time of placing investments. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service, and has access to the websites of Fitch, Moody's and Standard & Poor's.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

81. Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

**UK banks – ring fencing**

82. The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

83. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

84. While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

**Counterparties and investment limits 2022/23**

85. The proposed counterparties and investment limits for 2022/23 are unchanged from those for 2021/22 and are shown in the following table.

## Investment Counterparties 2022/23

| Category | Institutions | LAS Colour Code | Maximum Period | Limit per Institution |
|---|---|---|---|---|
| **Banks & Building Societies: Call Accounts /Term Deposits / Certificates of Deposit (CDs)** | | | | |
| Government related/guaranteed entities | DMADF (DMO) | Yellow | 6 months | Unlimited |
| | UK Local Authority | Yellow | 1 year<br>2 years | £3m per LA<br>£2m per LA; £4m in total |
| UK part-nationalised institutions | Royal Bank of Scotland group | Blue | 1 year | £4m per group |
| UK-incorporated Institutions | UK banks and building societies of high credit quality | Orange<br>Red<br>Green | 1 year<br>6 months<br>3 months | £5m per group (or institution if independent) |
| **Money Market Funds** | | | | |
| Money Market Funds | MMFs of high credit quality - AAA rated | | Instant access | £5m per fund |

**Investment strategy**

**In-house funds**

86. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. However, as Table 6 indicates, the Council is currently under-borrowed, which means that it is using its own cash balances to avoid taking external borrowing at higher rates of interest than it would achieve if it invested the cash. Cash balances are held only to manage the ups and down of cash flow, and in general they are held only in highly liquid accounts such as bank current accounts and Money Market Funds.

**Investment returns expectations**

87. Bank Rate is forecast to reach 0.75% by the end of March 2022, rising to 1.25% by the end of March 2023, before then remaining steady across the whole of the remaining period covered by this strategy report. Current Bank Rate forecasts for financial year ends (March) are shown below, compared to those from twelve months ago:

2021/22 0.75% Was 0.10% in 2021/22 Treasury Strategy report
2022/23 1.25% Was 0.10%
2023/24 1.25% Was 0.10%
2024/25 1.25%

88. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

| | Now | 2021/22 report |
|---|---|---|
| 2022/23 | 1.00% | 0.10% |
| 2023/24 | 1.25% | 0.10% |
| 2024/25 | 1.25% | 0.10% |
| 2025/26 | 1.25% | 0.20% |
| Following five years | 1.50% | 2.00% |
| Long-term later years | 2.00% | 2.00% |

89. The overall balance of risks to economic growth in the UK is now to the downside. This includes risks from Covid and its variants, both domestically and their potential effects worldwide.

90. It is not expected that Bank Rate will go up fast after the initial rate sharp rises over the next few months, as the supply potential of the economy is not likely to have taken a major hit during the pandemic. It should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after a spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know how severe an impact continuing variants of the virus may have on the
- Some of the current key supply shortages may spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages.
- There could be further severe impacts from continuing Covid variations.

91. In summary, with the high level of uncertainty prevailing on several different fronts and the expectation is that forecasts will have to be revised again during the year.

92. **Investment Treasury Indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

93. The Council is asked to approve the treasury indicator and limit:

| Table 10 - Maximum Principal Sums Invested > 365 Days | 2021/22 Revised £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|
| UK Government | 0 | 0 | 0 | 0 |
| UK Local Authorities ** | 4,000 | 4,000 | 4,000 | 4,000 |
| UK Banks & Building Societies | 0 | 0 | 0 | 0 |
| Non-UK Banks | 0 | 0 | 0 | 0 |
| **Total** | **4,000** | **4,000** | **4,000** | **4,000** |

** Maximum of £2 million per local authority

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, Money Market Funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

**Investment Risk Benchmarking**

94. The Council has previously set its investment performance benchmark based on the 7-day LIBID compounded rate. As was expected at the time when the 2021/22 Strategy was approved, the publication of official LIBOR figures and related LIBID calculations ceased at the end of December 2021. The replacement recommended by the Council's treasury management advisors is SONIA (Sterling Overnight Index Average), which is the risk-free rate for sterling markets administered by the Bank of England. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

95. SONIA is the Working Group on Sterling Risk Free Reference Rates' preferred benchmark for the transition to sterling risk-free rates from LIBOR/LIBID. To support this transition, the Bank of England began publishing the SONIA Compounded Index from 3 August 2020. This simplifies the calculation of compounded interest rates and in doing so provides a standardised basis through its publication as an official source.

96. Going forwards, the Council's advisors will be providing compounded SONIA rates to clients in the same way that they previously did with LIBOR / LIBID rates. Rates will be available for overnight, 7 day, 1, 3, 6 or 12 month compounded / SONIA, allowing a choice of the benchmark rate which is the most appropriate to the individual council.

97. It is recommended that the Council adopt SONIA for investment performance benchmarking purposes and that it applies the 7-day compounded rate, as being the most suitable to the Council's cashflows, the typical pattern of which means that funds will only seldom be available for investment for fixed terms of one month or more.

**End of Year Investment Report**

98. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

**IMPLICATIONS OF REPORT**

99. This report has implications in the following areas and the relevant Directors' comments are included:

| | | | |
|---|---|---|---|
| Finance | ✓ | Customer Services | |
| Human Resources | | Equality and Diversity | |
| Legal | ✓ | Integrated Impact Assessment required? | |
| No significant implications in this area | | Policy and Communications | |

**COMMENTS OF THE STATUTORY FINANCE OFFICER**

100. These are contained in the report.

**COMMENTS OF THE MONITORING OFFICER**

101. The recommendations are appropriate as explained in the body of the report.

LOUISE MATTINSON
CHIEF FINANCE OFFICER AND SECTION 151 OFFICER

| Background Papers | | | |
|---|---|---|---|
| **Document** | **Date** | **File** | **Place of Inspection** |
| CIPFA Treasury Management in the Public Services: Code of Practice & Guidance Notes (2021) | | | Town Hall |
| CIPFA Prudential Code for Capital Finance in Local Authorities (2021) | | | Town Hall |
| CIPFA Treasury Management in the Public Services: Guidance Notes for Local Authorities (2021) | | | Town Hall |
| CIPFA Standards of Professional Practice: Treasury Management | | | Town Hall |
| DLUHC Guidance on Local Government Investments | | | Town Hall |
| DLUHC Guidance on Minimum Revenue Provision | | | Town Hall |

| Report Author | Ext | Date | Doc ID |
|---|---|---|---|
| Tony Furber | 5027 | 8th February 2021 | |

**APPENDIX Hii)**

## ECONOMIC BACKGROUND PROVIDED BY LINK ASSET SERVICES

**COVID-19 vaccines.**

These were a significant development during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the emergence of the Omicron mutation at the end of November dampened this.

The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid.

The big question still remains as to whether any further mutations could emerge.

**MPC MEETING 16H DECEMBER 2021**

- The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.

- The MPC did not raise the Bank Rate at its November meeting. Until the Omicron variant emerged, most forecasters, viewed a Bank Rate increase as being near certain at this December meeting due to the way that worldwide inflationary pressures have been building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30th September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

- **On 10th December we learnt that the rise in GDP in October was just 0.1% m/m,** Early evidence suggests growth in November might have been marginally better.

- **On 14th December, the labour market statistics** for the three months to October and the single month of October were released. The fallout after the furlough scheme was smaller than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested that unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies from 1.182m to a record 1.219m in the three months to November which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.

- These figures by themselves, would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron complicated matters as it poses a risk to the economy. The financial markets again swung round to expecting no change in Bank Rate.

- **On 15th December we had the CPI inflation** figure for November which rose from 4.2% to 5.1%, confirming again how worldwide inflationary pressures have been building. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).

- **Other elements of inflation are also transitory** e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter is passed and demand for these falls away.

- This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC increased the Ba**nk Rate from 0.10% to 0.25%.** Indications are that the MPC is now concerned that inflationary pressures are building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022.

- It did also comment that **"the Omicron variant is likely to weigh on near-term activity".** But it stressed that at the November meeting it had said it would raise rates if the economy evolved as it expected and that now "these conditions had been met". It also appeared more worried about the possible boost to inflation from Omicron itself. It said that "the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation".

- On top of that, there were no references this month to inflation being expected to be below the **2% target in two years' time,** which at November's meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.

- These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only **a "modest tightening"** in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. As such, the Bank could be thinking about raising interest rates two or three times next year to 0.75% or 1.00%.

- In as much as a considerable part of the inflationary pressures at the current time are indeed **transitory,** and will naturally subside, this would appear to indicate that this tightening cycle is likely to be comparatively short.

- As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November's statement that Bank Rate would be raised "in the coming months". That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3rd February. Once 0.50% is reached, the Bank would act to start shrinking its stock of QE, (gilts purchased by the Bank would not be replaced when they mature).

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
    - Raising Bank Rate as "the active instrument in most circumstances".
    - Raising Bank Rate to 0.50% before starting on reducing its holdings.
    - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    - Once Bank Rate had risen to at least 1%, it would start selling its holdings.

**APPENDIX Hii)**

**LINK TREASURY SERVICES INTEREST RATE FORECASTS**

**A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE**

- The threat from Omicron was a matter of considerable national concern at the time of December's MPC meeting; but is now seen as much reduced.
- The MPC shifted up a gear last week in raising Bank Rate by another 0.25% and narrowly avoiding making it a 0.50% increase by a 5-4 voting margin.
- Our forecast now expects the MPC to deliver another 0.25% increase in March; their position appears to be to go for sharp increases to address the underlying issues quickly.
- The March increase is likely to be followed by an increase to 1.0% in May and then to 1.25% in November.
- The MPC is currently much more heavily focused on combating inflation than on protecting economic growth.
- The major question is whether the current spike in inflation will lead to a second-round effect in terms of labour demanding higher wages.
- If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.

**PWLB RATES**

- The yield curve has flattened out considerably.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate.
- It is difficult to say currently what effect the Bank of England starting to sell gilts will have on gilt yields once Bank Rate rises to 1%: it is likely to act cautiously as it has already started on not refinancing maturing debt. A passive process of not refinancing maturing debt could begin in March when the 4% 2022 gilt matures; the Bank owns £25bn of this issuance. A pure roll-off of the £875bn gilt portfolio by not refinancing bonds as they mature, would see the holdings fall to about £415bn by 2031, which would be about equal to the Bank's pre-pandemic holding. Last August, the Bank said it would not actively sell gilts until the "Bank Rate had risen to at least 1%" and, "depending on economic circumstances at the time."
- It is possible that Bank Rate will not rise above 1% as the MPC could shift to relying on quantitative tightening (QT) to do the further work of taking steam out of the economy and reducing inflationary pressures.

**MPC MEETING 4TH FEBRUARY 2022**

- After the Bank of England became the first major western central bank to put interest rates up in this upswing in December, it has quickly followed up its first 0.15% rise by another 0.25% rise to 0.50%, in the second of what is likely to be a series of increases during 2022.
- The Monetary Policy Committee voted by a majority of 5-4 to increase Bank Rate by 25bps to 0.5% with the minority preferring to increase Bank Rate by 50bps to 0.75%. The Committee also voted unanimously for the following: -
  - to reduce the £875n stock of UK government bond purchases, financed by the issuance of central bank reserves, by ceasing to reinvest maturing assets.
  - to begin to reduce the £20bn stock of sterling non-financial investment-grade corporate bond purchases by ceasing to reinvest maturing assets and by a programme of corporate bond sales to be completed no earlier than towards the end of 2023.
- The Bank again sharply increased its forecast for inflation – to now reach a peak of 7.25% in April, well above its 2% target.

- The Bank estimated that UK GDP rose by 1.1% in quarter 4 of 2021 but, because of the effect of Omicron, GDP would be flat in quarter 1, but with the economy recovering during February and March. Due to the hit to households' real incomes from higher inflation, it revised down its GDP growth forecast for 2022 from 3.75% to 3.25%.
- The Bank is concerned at how tight the labour market is with vacancies at near record levels and a general shortage of workers.
- As in the December 2021 MPC meeting, the MPC was more concerned with combating inflation over the medium term than supporting economic growth in the short term. However, what was notable was the Bank's forecast for inflation: based on the markets' expectations that Bank Rate will rise to 1.50% by mid-2023, it forecast inflation to be only 1.6% in three years' time. In addition, if energy prices beyond the next six months fell as the futures market suggests, the Bank said CPI inflation in three years' time would be even lower at 1.25%. With calculations of inflation, the key point to keep in mind is that it is the rate of change in prices – not the level – that matters. Accordingly, even if oil and natural gas prices remain flat at their current elevated level, energy's contribution to headline inflation will drop back over the course of this year. That means the current energy contribution to CPI inflation, of 2% to 3%, will gradually fade over the next year.
- So the message to take away from the Bank's forecast is that they do not expect Bank Rate to rise to 1.5% in order to hit their target of CPI inflation of 2%. The immediate issue is with four members having voted for a 0.50% increase in February, it would only take one member more for there to be another 0.25% increase at the March meeting.

**The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative tightening) holdings of bonds is as follows: -

1. Raising Bank Rate as "the active instrument in most circumstances".
2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

**OUR FORECASTS**

**a. Bank Rate**

- Covid remains a major potential downside threat as we are most likely to get further mutations. However, their severity and impact could vary widely, depending on vaccine effectiveness and how broadly it is administered.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again.

**b. PWLB rates and gilt and treasury yields**

**Gilt yields.** Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for medium to longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

**The balance of risks to the UK economy**: -

**Downside risks to current forecasts for UK gilt yields and PWLB rates include: -**

- **Mutations** of the virus render current vaccines ineffective
- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.
- **Bank of England** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **Geopolitical risks**, for example in Ukraine/Russia, Iran, China, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

**Upside risks to current forecasts for UK gilt yields and PWLB rates: -**

- **The Bank of England** is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast.

**APPENDIX Hii)**

**Comparison of Interest Rate Forecasts – Treasury Strategy 2021/22 – 2023/24 (Jan 2020), and Treasury Strategy 2022/23 – 2024/25 (Feb 2022)**

| | Bank Rate % | | | PWLB Borrowing Rates % (including 0.20% certainty rate adjustment) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 5 year | | | 10 year | | | 25 year | | | 50 year | | |
| | Feb 22 | Nov 21 | Feb 21 | Feb 22 | Nov 21 | Feb 21 | Feb 22 | Nov 21 | Feb 21 | Feb 22 | Nov 21 | Feb 21 | Feb 22 | Nov 21 | Feb 21 |
| Mar-22 | 0.75 | 0.25 | 0.10 | 2.20 | 1.50 | 1.00 | 2.30 | 1.90 | 1.40 | 2.40 | 2.20 | 2.00 | 2.20 | 2.00 | 1.80 |
| Jun-22 | 1.00 | 0.50 | 0.10 | 2.30 | 1.60 | 1.00 | 2.40 | 1.90 | 1.40 | 2.50 | 2.30 | 2.00 | 2.30 | 2.10 | 1.80 |
| Sep-22 | 1.00 | 0.50 | 0.10 | 2.30 | 1.60 | 1.10 | 2.40 | 2.00 | 1.50 | 2.50 | 2.40 | 2.10 | 2.30 | 2.20 | 1.90 |
| Dec-22 | 1.25 | 0.50 | 0.10 | 2.30 | 1.70 | 1.10 | 2.40 | 2.00 | 1.50 | 2.60 | 2.40 | 2.10 | 2.40 | 2.20 | 1.90 |
| Mar-23 | 1.25 | 0.75 | 0.10 | 2.30 | 1.70 | 1.10 | 2.40 | 2.10 | 1.50 | 2.60 | 2.40 | 2.10 | 2.40 | 2.20 | 1.90 |
| Jun-23 | 1.25 | 0.75 | 0.10 | 2.30 | 1.70 | 1.20 | 2.40 | 2.10 | 1.60 | 2.60 | 2.50 | 2.20 | 2.40 | 2.30 | 2.00 |
| Sep-23 | 1.25 | 0.75 | 0.10 | 2.30 | 1.80 | 1.20 | 2.40 | 2.20 | 1.60 | 2.60 | 2.50 | 2.20 | 2.40 | 2.30 | 2.00 |
| Dec-23 | 1.25 | 0.75 | 0.10 | 2.30 | 1.80 | 1.20 | 2.40 | 2.20 | 1.60 | 2.60 | 2.60 | 2.20 | 2.40 | 2.40 | 2.00 |
| Mar-24 | 1.25 | 1.00 | 0.10 | 2.30 | 1.80 | 1.20 | 2.40 | 2.20 | 1.60 | 2.60 | 2.60 | 2.20 | 2.40 | 2.40 | 2.00 |
| Jun-24 | 1.25 | 1.00 | | 2.30 | 1.90 | | 2.40 | 2.30 | | 2.60 | 2.60 | | 2.40 | 2.40 | |
| Sep-24 | 1.25 | 1.00 | | 2.30 | 1.90 | | 2.40 | 2.30 | | 2.60 | 2.60 | | 2.40 | 2.40 | |
| Dec-24 | 1.25 | 1.00 | | 2.30 | 2.00 | | 2.40 | 2.30 | | 2.60 | 2.70 | | 2.40 | 2.50 | |
| Mar-25 | 1.25 | 1.25 | | 2.30 | 2.00 | | 2.40 | 2.40 | | 2.60 | 2.70 | | 2.40 | 2.50 | |

The February 2021 forecasts were included in Treasury Strategy 2021/22 to 2023/24.
Link Asset Services provided an updated forecast in February 2022.